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The Reparations Settlement—Its Relation to American Business Revival

By JAMES G. McDONALD

Chairman, Executive Committee, Foreign Policy Association

OUR business depression is primarily European, not American, in its origin. More than two hundred million human beings east of the Rhine are underproducing and underconsuming. They cannot pay for the necessities, much less the luxuries, of life. Now that the artificial stimulus of the war has ceased, agriculture, industry and commerce in all parts of the world are seriously affected and must continue to be until something like normal conditions are reestablished in eastern Europe and Russia. For us the effects of post-war deflation have been unusually severe because of the extraordinary expansion of our foreign trade since 1914. The extent of contraction during the last twelve months is strikingly illustrated by the figures just published by the Department of Commerce. During the fiscal year ending June 1, American foreign trade, exports and imports, as compared with the previous year, has fallen off more than \$3,000,000,000. For June, 1921, exports and imports total \$643,000,000 less than for June, 1920. This is a loss at the rate of more than \$7,500,000,000 a year. If we are not to be forced drastically to readjust our export business to proportions as modest as those before 1914, we must concern ourselves with the restoration of the European market, which so far as central and eastern Europe are concerned, depends primarily on Germany.

No serious student of the European economic situation doubts that the primary consideration in Germany's economic recovery is her capacity to

meet the reparations and obligations which she has assumed. It is now everywhere recognized that, had the amount of the reparations been definitely fixed at the time of the Peace Conference within Germany's recognized ability to pay, the world would today be immeasurably farther on the road towards economic rehabilitation. The failure to agree upon a definite figure until more than two and one-half years after the Armistice (the Allied Reparations Protocol, which was an ultimatum, was accepted by Germany May 10, 1921) has materially retarded Germany's recovery and consequently her ability to pay, has delayed very seriously the restoration of anything like pre-war economic conditions in eastern and southern Europe, so closely related commercially to Germany, and has been an important factor in bringing on the present industrial depression here by destroying the foreign market for much of our export products, particularly cotton, wheat, copper and machinery. It is, therefore, to the interest of the Allies, to the rest of Europe and to ourselves, that the recent assessment of Germany's obligations should now be considered not from the point of view of war passions or from that of abstract justice, but rather with a view to determining whether this settlement finally agreed upon does tend, in fact, to strengthen the recuperative forces in Europe, or whether this arrangement ought to be modified if it is to contribute most largely to the reconstruction of the shattered fabric of Europe's industrial, agricultural and commercial life.

THE REPARATIONS SETTLEMENT

On May 1, the Reparations Commission, acting in conformity with the Treaty, announced that it had fixed the capital sum of Germany's obligations at 132,000,000,000 gold marks, or approximately \$33,000,000,000. It is not clear whether the, approximately, \$1,500,000,000 already paid before May 1 by Germany is to be deducted from this amount. According to the Treaty provisions, the Reparation Commission was required to outline a program for the payment of this entire amount with interest at 5 per cent within thirty years. This would have meant an annual payment by Germany of more than \$2,000,000,000—a commitment clearly impossible.

Taking this difficulty into consideration, the Supreme Council of the Allies, doubtless in consultation with the Reparations Commission, worked out a schedule of payments which constitute Germany's real obligations. This schedule accepts the figure of \$33,000,000,000 as the total of Germany's capacity and requires the payment annually of \$500,000,000 plus 26 per cent of the value of German exports. It is calculated that at present this percentage would amount approximately to \$250,000,000, thus bringing the annual payments to three-quarters of a billion dollars. These payments will, of course, be increased proportionately as Germany's export trade increases. This program, then, is, as Mr. Paul D. Cravath pointed out in his detailed article on "The Reparations Settlement" in *The New York Herald*, Sunday, June 26, "the measure, and the sole measure, of the annual payments which Germany is required to make under the new agreement."

It was further provided that the German government deliver before

November 1, three series of bonds which together would represent the capital sum of her total obligations. The first series are "A" bonds, to be delivered by July 1, for \$3,000,000,000; the second series, "B" bonds, to be delivered by September 1, for \$9,500,000,000; the third series, "C" bonds, to be delivered before November 1, for approximately \$20,500,000,000. These last, however, are not to have coupons attached, nor are they to bear interest until German industry and trade have recovered sufficiently to pay more than the assessed 6 per cent on the first two bond issues.

It is very surprising that the *Federal Reserve Bulletin* for June, 1921, on page 650, implies that these "C" bonds bear interest in the same way as do the "A" and "B" bonds. This suggestion appears to be in direct contradiction to the text of the Reparations Protocol, reprinted on pages 674-676 of the same issue of the Bulletin and also in contradiction to the official explanation of the Protocol given by Mr. Lloyd George in the House of Commons on May 5, reprinted on page 651.

An amount equal to 6 per cent upon the \$12,500,000,000 of the first two series of bonds is to be applied to the payment of interest and sinking funds for Series "A" and "B." This payment is to be made only upon bonds actually outstanding, the remainder to be paid into the sinking fund for the redemption of bonds at par.

Series "C" bonds are to begin bearing interest when the Reparations Commission is convinced that the German payments of \$500,000,000 plus 26 per cent of the exports, is more than sufficient to provide for the interest and sinking fund charges on the Series "A" and "B." In any event, the priority of lien of the bonds is to be in the alphabetical order.

CRUX OF SETTLEMENT IS GERMANY'S FOREIGN TRADE

The crux of the new program lies in the provision that the amount of Germany's annual payments, as well as the period required for satisfaction of her entire obligation, depends primarily upon the volume of her foreign business, more especially her export trade. It is, therefore, possible to estimate with some degree of assurance the probabilities of Germany's capacity to meet her commitments.

Much confusion as to Germany's capacity to pay has been caused by writers and readers not differentiating carefully enough between the gold mark of the normal value of about 24 cents and the paper mark, at present fluctuating between the value of 1.25 cents and 1 cent and a half. The minimum annual payments of Germany, therefore, in terms of paper marks must reach the total of at least 12,000,000,000 paper marks.

It is also frequently urged that, since the Germans at Versailles two and a half years ago offered a reparations payment of 100,000,000,000 gold marks at the rate of 4,000,000,000 annually, surely they can now pay interest at 5 per cent and 1 per cent amortization on a capital sum of 132,000,000,000 gold marks. It should be remembered, however, that Germany predicated this offer upon several conditions, most of which have been ignored, such as the capital sum not bearing interest, the retention of all of German Poland, Silesia, all her merchant marine, the Saar Valley, the colonies, etc. Moreover, since the spring of 1919, general

financial disintegration has set in and the reichsmark has depreciated from 8 cents to less than a cent and a half.

It is also suggested that Germany must be prosperous because of the issues during the past year of new securities aggregating approximately 14,000,000,000 marks. But here again we are dealing with paper marks, which means that the total amount of securities issued represents perhaps less than 1,000,000,000 gold marks, or approximately \$250,000,000. This total is less than one-tenth the amount of securities issued in the United States during the same time. In the same way startling statistics describing vast dividends of German corporations should be read in the light of these being paper mark dividends on what in most cases is a gold capitalization.

Some estimate of Germany's capacity to make the reparation payments out of the excess of her exports over imports can be made from the trade figures below, for the years immediately preceding the war.

On an average her exports were less than her imports by about 1,500 million marks annually. This deficiency was made up from proceeds of foreign investments, proceeds from shipping, insurance, etc. The bulk of her foreign investments have now been wiped out or are impounded; her mercantile fleet has been taken over by the Allies and her foreign insurance business cannot amount to any considerable item for some time.

It should also be borne in mind that of Germany's export trade before the war, more than 600 millions consisted

IN MILLION GOLD MARKS

	1913	1912	1911	1910	1909
Imports	10,770	10,691	9,705	8,934	8,526
Exports	10,096	8,957	8,106	7,474	6,594
Excess of Imports	674	1,734	1,599	1,460	1,932

of coal. It is very doubtful whether she can consider coal as an item of equal importance in her future balance sheet, inasmuch as she is committed to deliver all that she can reasonably spare to the Allies directly on the reparation account. To what extent she will be able to maintain her steel and iron trade (which amounted annually to two billion marks out of ten) is somewhat doubtful, since in the future she will have to import much of her iron ores, which were formerly within her own boundaries, and in view of the limited supply of coal available for that industry.

With her exporting powers thus diminished, her shortage of foodstuffs, fertilizers and other raw materials has become so serious that it is not improbable that during the next few years the balance of trade will be more heavily against Germany than before the war. If through her export business she is unable to pay for the raw materials required for her 60,000,000 people, the general standard of living must be materially reduced and the average rate of production substantially increased. How far this can be done will depend both upon the endurance and morale of the masses and the degree of governmental control that may safely be imposed.

It is a grave question, however, and one carefully to be weighed, how far this "sweating process" of a people may safely go; because the crippling of Germany's foreign purchasing power and of her domestic coal supply (which of necessity is involved in this plan) means continued under-nourishment, poor clothing, freezing and hard work for the poorer classes—a condition which we politely call reduced standard of living. To go too far in this respect would not only be cruel and destructive, but would also, incidentally, be poor business.

THE GRAVEST QUESTION IS WHAT THE WORLD CAN AFFORD TO RECEIVE FROM GERMANY

But even were it possible for Germany, by reducing her standard of living and increasing her productivity, to create a sufficient surplus for export to fulfil the full measure of her reparations obligations, it is very doubtful if a market could be found for her products. Indeed, in the light of the nearly two years' experience that the Reparations Commission has had in executing the reparation clauses of the Treaty, it is now evident that the problem of securing adequate indemnity from Germany is not so much a question of what Germany owes, or even of what Germany can pay, but rather, as was brilliantly pointed out in a recent address by John Foster Dulles, formerly counsel to the American Peace Commission and member of the Reparation Commission and Supreme Economic Council, a question of what the Allies and the rest of the world think they can afford to receive from Germany.

Germany's initial payment as fixed by the Treaty itself was to be \$5,000,000,000, payable before May 1, 1921. The Allied experts during the Peace Conference estimated that these payments would be made principally through ships, coal, machinery, reconstruction material, chemicals, dyestuffs and German labor. The story of the growing unwillingness of the Allies to receive these forms of payments, the only ones which Germany has available in values sufficiently great to count materially towards reparation payments, is illuminating.

German ships are today a drug on the market. British ship owners have protested against the receipt of any more enemy shipping. The Leviathan, rotting in the docks at Hoboken, is another case in point. Moreover, the

Allied experts have recommended that Germany be relieved from the provisions of the Treaty requiring her to build ships on the reparation account.

Coal would seem to be one of the most important of German means of paying reparation. France needs it. Most of the rest of Europe is naturally a consumer of German coal. But the interests of Britain, the largest exporter of coal to the Continent, would be seriously jeopardized by the unrestricted utilization of German coal for indemnity payments, not merely because it would mean direct competition in the coal markets, but also because British industry has long enjoyed the advantage of cheap fuel, in part because of the high price which British coal has commanded in the continental markets.

But what of machinery and reconstruction materials? Surely these economic values France and Belgium have been willing to utilize in large measure. The Treaty gave these states practically an absolute right to requisition whatever German materials in these classes they might desire. Up to October of last year, a report of the Reparation Commission shows that not a single piece of machinery has been accepted by France and very few by Belgium. The French insist that to utilize German machinery and supplies would be to give the German manufacturers a virtual monopoly in supplying parts and replacements.

German dyestuffs and chemicals are everywhere unwelcome. German labor—has it been more welcome in the work of reconstruction in France? Though France strenuously insisted upon her right to demand such assistance, and though Germany has frequently volunteered to supply laborers in large numbers, this form of assistance has not been accepted.

It is thus evident that Germany's

ability to pay through the mediums here discussed—ships, coal, machinery, chemicals, dyestuffs and German labor—is seriously limited by the Allies' capacity or willingness to receive payment in these forms. In any event, the bulk of whatever Germany has in liquid assets, ships, assets and securities in Allied countries, rolling stock, etc. has already been taken over. It has been suggested, however, that Germany might transfer to the Allies large blocks of securities in her leading corporations. According to some of the American experts at the Peace Conference, such securities have been unacceptable because of the fear that their receipt might create in the Allied countries an undue interest in the economic recovery of Germany.

But would not the transfer of ownership of considerable portions of German securities to the Allies permanently impair Germany's capacity to make subsequent reparation payments in other forms? Would not the payment of interest and dividend charges to foreign holders of basic securities tend still further to depreciate the reichsmark to such a point as to make it almost valueless? The history of German finance since the Armistice is illuminating on this point. In November, 1918, there were several million marks gold due to neutral countries from Germany. If a statesmanlike program had been worked out at that time, enabling Germany to pay reparations by creating obligations in amounts clearly within her power to pay, and if, at the same time, the blockade had been lifted and Germany had been supplied with the raw materials essential to her rehabilitation, the neutral countries would doubtless have accepted some sort of paper obligation from Germany in payment of the amounts due them. However, since Germany's obligations to the Allies remained indefinite and

since no constructive efforts were made at assisting her recuperation, she has been forced to permit her neutral creditors to sell reichsmarks as rapidly as the market would absorb them. This is one of the decisive reasons for the continued decline of the value of the mark. With depreciated marks these neutrals have made such extensive purchases of movable and immovable property that a considerable percentage of stocks and bonds of German corporations, as well as of state and municipal securities, are now owned by non-Germans. The disastrous effect of such a development is obvious. If Germany is forced to make gold payments beyond either her capacity to pay in goods or the world market's capacity to absorb her products, the ultimate outcome would be the surrender of the country's assets to foreign capitalists, the corresponding dwindling of Germany's domestic power of taxation and the complete cessation of indemnity payments, as in Austria.

SHOULD GERMANY BE PERMITTED TO PAY?

It is clear, therefore, that only one basic method of payment is left to

Germany, that is, through credits accumulated in foreign markets as the result of profits on her export trade. This involves the development of German trade on an unprecedented scale and in markets where the currency is at a high premium. No one can estimate how much Germany could pay if the rest of the world opened their markets to her without let or hindrance and made no serious attempts at competition. But it is obvious that the world will not give Germany a free field and that the United States, least of all, would be willing to do so. Is it not an open question, therefore, whether, from the point of view of American commerce and the revival of American business, Germany ought be permitted to fulfill her reparations commitments?

The statistics in reference to the destination of Germany's exports and the source of her imports is illuminating on this point.

As Mr. Cravath, who cites these figures in his article in *The Herald*, points out:

From this table it appears that 34 per cent of Germany's imports were from the British Empire and the United States and that 25 per cent of her exports were to

GERMAN EXPORTS

To the United States	\$178,000,000
To the British Empire	456,000,000
To France	197,000,000
To Italy	98,000,000
To Russia	220,000,000
To the rest of the world	1,371,000,000
TOTAL	\$2,520,000,000

GERMAN IMPORTS

From the United States	\$427,000,000
From the British Empire	491,000,000
From France	146,000,000
From Italy	79,000,000
From Russia	356,000,000
From the rest of the world	1,192,000,000
TOTAL	\$2,691,000,000

those countries. This very practical question may soon be presented: Will the United States, which does not share in the reparation payments, and Great Britain, which receives only 22 per cent of them, be willing to encourage Germany in the policy of reducing her imports from those countries to the minimum and forcing her exports to those countries and to the competitive markets of the world to the maximum?

In the present state of disorganization in Russia and southeastern Europe it would follow that an even larger proportion of German exports than before the war must come to Great Britain and to the United States. In view of the new Administration's announced determination to prevent such "dumping," it would be absurd to expect Germany to be able to accumulate credits in the United States sufficient to pay during a period of years even the minimum annual reparation payment.

THE POSSIBLE WAYS OUT OF THE DILEMMA

Germany, in view of her promise to fulfill to the letter the reparation agreement, has a primary duty to make every effort to meet the demands required. The United States, as a co-victor with the Allies in the war, has a right equal to that of the Allies to interest herself in this question. If, as seems more than probable, at the end of a very few years, events prove that the obligations assessed against Germany are beyond her capacity to pay, one of two policies will be followed: Either the military sanctions provided for in the reparations ultimatum will be enforced and the virtual break-up of

Germany begun; or a general revision of the reparations settlement will be made—a revision not primarily in the interest of Germany, but in the interest of the reestablishment of normal trade conditions throughout the world. To put the question in this way gives a decisive answer as to what the attitude of the United States should be.

The effect of the reestablishment of Germany as a prosperous going concern upon our own trade and commerce, was succinctly summarized recently by Mr. Bernard M. Baruch, a member of the American Reparations Commission at Paris, as follows:

If Central Europe could be set to functioning, its organizing ability and genius for distribution would stimulate an increase in all of our activities. The railroad problem would be solved, because of the enormous increase in the volume of business offered. Our agricultural problem would be solved, because of the increased markets for all of the things we grow. Unemployment would cease, and it would be possible, because of the greater volume of business, to decrease the ratio of taxes.

The revival of American business cannot be disassociated from the revival of business in Central Europe. Considerations of self-interest and those of disinterested world statesmanship point towards the use of American influence, financial and political, in behalf of such an interpretation of the reparations settlement or, if later it proves necessary, such a revision of that settlement as will, by most speedily restoring the European market, expedite the return of normal international economic conditions everywhere.